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# **South Carolina Office of the State Treasurer**

## **Department of Internal Audit**

### **Policies and Procedures Manual**

CPM 2016 Project

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SC Office of the State Treasurer

**South Carolina Office of the State Treasurer  
Department of Internal Audit  
Policies and Procedures Manual**

**The Problem Statement**

I recently changed career path from the SC Department of Revenue (Controller), to SC Office of the State Treasures (Internal Audit Manager). My Internal Audit background encompassed over twenty years of experience, to include, but not limited to the Federal Government, Commercial Banking and State Government. During interview process it was brought to my attention that the State Treasures Office (STO) had been without an Internal Audit Department for quite a few years. All functions and activities relating to the Internal Audit Department were being outsource to 3<sup>rd</sup> Party Accounting & Audit Firms. The current administration had decided to bring the Internal Audit function back in-house, for both efficiency and economic reasons.

The purpose of this project is to develop a Policy and Procedures Manual (P&P), as a written guidance for applicable and required procedures to identify processes which will improve the effectiveness of risk management, control, and governance process through the agency's Internal Audit functions. Additionally the establishment of the Internal Audit Department and applicable P&P are to provide the agencies' Senior Management and the State Treasurer with an ongoing assessments of the agencies' risk management processes, and systems of internal controls. The Internal Audit functions are established and will be directed by Professional Standards use by Auditors who audit governmental organizations programs, activities and functions which includes *The United States General Accounting Office's - Generally Accepted Government Auditing Standards* (Yellow Book) and *The Institute of Internal Auditors' - Standards for the Professional Practice of Internal Auditing* (Red Book).

In developing an Internal Audit Department and the development of its P&P encompassed meetings and detailed conversations with local established state agencies Internal Audit Directors/Managers. This was to gain their personal insight into establishing an Internal Audit Department, and the development of a relevant P&P. Additionally, I researched multiple periodicals relating to the subject matter, to include, but not limited to *Establishing an Internal Audit Department: The Case of the Schwan Food Company*<sup>1</sup> which distinguishes why an Internal Audit Department should be established, with emphasis on the development of written Audit Charter, which delineates the purpose, authority, and responsibility of the Internal Audit Department. The Audit Charter, approved by the State Treasures, is critical for sending the right message throughout the organization that Internal Audit is viewed as viable and a priority. Once approved, the P&P, which contains the Audit Charter, will be disseminated through the agency, and discussed in detail with both Senior Management and the agency as a whole.

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<sup>1</sup> Pforsich, Hugh; Peterson Kramer, Bonita K.; and Just, G. Randolph (2008) "Establishing an Internal Audit Department: The Case of the Schwan Food Company," *Global Perspectives on Accounting Education*: Vol. 5: Iss. 1,

## **Table of Contents**

<b>I. Introduction</b>	<b>3</b>
- Definition of Internal Audit	
- Mission Statement	
- Objective	
- Independence	
- Confidentiality	
- Report Structure	
<b>II. Internal Audit Department Charter</b>	<b>5</b>
- Mission	
- Accountability, Authority & Scope	
- Professional Standards & Code of Ethics	
- Responsibility	
<b>III. Audit Planning</b>	<b>10</b>
<b>IV. Audit Process</b>	<b>11</b>
- Risk Management	
<b>V. Audit Procedures</b>	<b>13</b>
- Evidential Matter	
- Types of Evidence	
- Documentation of Evidential Matter	
- Types of Sample	
- Auditing Finding	
<b>VI. Audit Reports</b>	<b>15</b>
- Policy	
- Description	
- Procedures	
<b>VII. External Auditors</b>	<b>18</b>
- Policy	
- Procedures	
<b>VIII. Follow-up Reviews</b>	<b>19</b>
<b>IX. Exhibits:</b>	<b>22</b>
<b>X Bibliography</b>	<b>28</b>



**South Carolina Office of the State Treasurer  
Department of Internal Audit  
Policies and Procedures Manual**

**Issue: January 2016**

**Update/Revision:**

**I. Introduction**

The Office of the State Treasurer is responsible for the investment, cash management, and safekeeping of the State's general and restricted funds, as well as the custodian of the \$30 billion in retirement funds of the South Carolina Retirement Systems. The Office also provides fiscal management services, including receipt and disbursement of all funds. The Office coordinates all banking services, manages the State's debt, administers the Unclaimed Property and College Savings Programs and works and communicates regularly with the three major bond rating firms to maintain high credit ratings that keep the State's borrowing costs low. The Office invests the excess funds of the State as well as the local governments and political subdivisions. The Office of the State Treasurer operate with five major program areas: Treasury Management; Investment Management; Debt Management; Unclaimed Property; and College Savings Plans.

**Definition of Internal Audit**

Internal Audit (IA) is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process.

**Mission Statement**

The mission of the Internal Audit Department is to provide independent and objective reviews and assessments of the business activities, operations, financial systems and internal accounting controls of South Carolina Office of the State Treasurer. The Internal Audit Department accomplishes its mission through the conduct of operational, financial and performance audits, selected as the result of a risk identification and assessment process. The resulting schedule of audits is reviewed and approved by the agency Chief of Staff. The mission will be accomplished by:

- Employing innovative approaches in performing independent assessments of systems, controls and efficiencies; guided by professional standards
- Supporting sections within the agency to achieve their objectives
- Promoting the full understanding, acceptance, and use of the IA function by all section management
- Rendering assessments and advice for improving activities that will advance the goals and objectives of the agency
- Maintaining a dynamic, team-oriented environment, within the agency to excel and reach its full potential



### **Objective**

The Internal Audit Department conducts independent reviews and appraisals of the South Carolina Office of the State Treasurer procedures and operations. These reviews provide management with an independent appraisal of the various operations and systems of control. The reviews also help to ensure the Office of the State Treasurer resources are used efficiently and effectively while helping the Office of the State Treasurer achieve its mission, as directed by the State Treasurer and the agency Chief of Staff. It is the intention of the Internal Audit Department to perform this service with professional care and with minimal disruption to the agency's operations.

### **Independence**

In order to maintain independence and objectivity, the IA function has no direct responsibility or any authority over the activities or operations that are subject to review, nor should IA develop or install procedures, prepare records or engage in activities that would normally be subject to review. However, IA may be consulted when new systems or procedures are designed to ensure they adequately address internal controls.

### **Confidentiality**

All information obtained during an IA is deemed confidential unless otherwise instructed. It is understood that certain items are confidential in nature and special arrangements may be required when examining and reporting on such items. Internal Audit will handle all information obtained during a review in the same prudent manner as the original custodian of the information. Internal Audit respects the value and ownership of information received and will not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

Audit reports are considered highly confidential. They are distributed to the respective area Managers, Deputy State Treasurers, Chief of Staff, and State Treasurer as requested. Other individuals interested in the audit report may gain access by contacting IA; with the approval of the appropriate management.

Internal Audit is expected to remain prudent with all information obtained during the course of an audit. When discussing matters pertaining to an audit or any other agency matters, IA must always remain discreet and be certain to limit those conversations exclusively to appropriate agency personnel. Internal Audit has an obligation to never indiscreetly discuss any information obtained during the course of audit assignments, whether within or outside the agency.

### **Reporting Structure**

Internal Audit report functionally and administratively to the Agency's Chief of Staff. The reporting structure and charter allows independence of the activities audited, and provide the authority necessary for full, free and unrestricted access to all operations, records, property and personnel within the Agency.

## **South Carolina Office of the State Treasurer**

### **Internal Audit Charter**

#### **II. Internal Audit Charter**

Internal Audit, as defined by the Institute of Internal Auditors, is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. This charter defines the mission, authority and responsibilities of the ***Internal Audit Section*** established by policy of South Carolina Office of the State Treasurer.

#### **Mission**

Internal Audit shall function as an independent appraisal activity within the Office of the State Treasurer to provide a protective and value added service to management and the Agency in discharging their duties and responsibilities. This mission is achieved by providing objective analyses, assessments, recommendations and commentary concerning activities reviewed. Additionally, Internal Audit will seek opportunities to provide consulting services to its internal customer base in an effort to add value and improve organizational efficiencies and effectiveness.

#### **Accountability, Authority & Scope**

Internal Audit reports functionally and administratively to the Agency's Chief of Staff. Internal Audit operates under the daily supervision of the Agency's Chief of Staff in support of its day to day administrative needs, in addition to reporting to the Agency's Chief of Staff as to its activities and published reports. This reporting relationship promotes independence and objectivity, which assures adequate consideration of audit recommendations and planned corrective actions.

Internal Audit has complete independence with respect to the units under audit and, consequently, is not subject to restriction in the scope of its work by operating unit or staff management. Further, the Agency Management does not place any restrictions on the scope of the audits. However, it is acknowledged that the Agency management via the Agency's Chief of Staff and The State Treasurer provide concurrence as to the scope of work and the activities to be audited, and may request Internal Audit to carry-out special reviews or audits.

In performing its function, Internal Audit has no direct responsibility or authority over any of the activities it reviews. Internal Audit is authorized full, free and unrestricted access to all areas, activities, records, property, information sources and personnel of the Agency necessary to carry out its activities. No legitimate source of information is to be closed to Internal Audit. Documents and information provided to Internal Audit during an examination are handled in the same discreet manner as by those employees normally accountable for them. Internal Audit is obligated to protect the privacy of confidential and proprietary information accessed during the course of its activities.

Internal Audit shall be free from control or undue influence in the selection and application of audit techniques, procedures and programs. Internal Audit shall be free from control or undue influence in the determination of facts revealed by the examination or in the development of recommendations or



opinions as a result of the examination. Internal Audit shall be free from undue influence in the selection of areas, activities, personal relationships and managerial policies to be examined.

The scope of work of Internal Audit is to determine whether the agency's network of risk management, control, and governance processes, as designed and represented by management, is adequate. This can include, but is limited to the following methods, activities and tasks:

- Reviewing and appraising the soundness of controls and the reliability and integrity of financial, managerial and operating data.
- Ascertaining compliance with the agency's policies and procedures.
- Evaluating the economy and efficiency with which resources are employed.
- Reviewing operations or programs to assess whether they are being carried out as planned and whether results are consistent with the established overall objectives of the agency.
- Serving on task forces and project teams that analyze and develop systems of operations.
- Facilitate self-assessments to help departments identify objectives and evaluate business risks and controls as a means of assisting departments with ongoing risk management.
- Performing consulting services where necessary and appropriate.

### **Professional Standards and Code of Ethics**

*The Institute of Internal Auditors, Inc.*, an international organization dedicated solely to the advancement of the internal auditing profession, has adopted "**Standards for the Professional Practice of Internal Auditing**". These standards are commonly referred to as "Red Book". Internal Audit recognizes the benefits of these standards and hereby adopts the "Standards for the Professional Practice of Internal Auditing" as an integral part of its Charter.

*The United States General Accounting Office* promulgates "**Generally Accepted Government Auditing Standards**" (**GAGAS**), for use by auditors who audit governmental organizations, programs, activities and functions. These standards are commonly referred to as "Yellow Book". Internal Audit recognizes the benefits of GAGAS and adopts the use thereof.

*\*\*\*In the rare circumstance where conflict of standards call for a determination of which standard would be most appropriate Internal Audit will make the determination based on the standard that will allow for the more conservative approach. Additionally, to the extent of any inconsistencies between the standards (red book vs. yellow book), GAGAS, yellow book, should prevail as the controlling (authoritative) source as applicable to governmental organizations such as SC Office of the State Treasurer.*

Additionally, Internal Audit has an obligation of self-discipline above and beyond the requirements of laws and regulations. They must uphold and demonstrate qualities of integrity, honesty, loyalty, morality, dignity, and confidentiality consistent with the "**Institute of Internal Auditors Code of Ethics**".



## Code of Ethics

### **Introduction to the Code of Ethics**

The purpose of The Institute's Code of Ethics is to promote an ethical culture in the profession of internal auditing.

*Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.*

A code of ethics is necessary and appropriate for the profession of internal auditing, founded as it is on the trust placed in its objective assurance about governance, risk management, and control.

The Institute's Code of Ethics extends beyond the Definition of Internal Auditing to include two essential components:

1. Principles that are relevant to the profession and practice of internal auditing.
2. Rules of Conduct that describe behavior norms expected of internal auditors. These rules are an aid to interpreting the Principles into practical applications and are intended to guide the ethical conduct of internal auditors.

### **Principles**

Internal Audit staff shall subscribe to the Code of Ethics established by the Institute of Internal Auditors, as well as adhere to the policies set forth by the management of South Carolina Office of the State Treasurer. In addition, the Internal Audit will apply and uphold the following principles:

- 1. Integrity** - Establish trust and thus provide the basis for reliance on the judgment of Internal Audit. Remain tactful, honest, objective and credible in all relationships as a representative of the Office of the State Treasurer.
- 2. Objectivity** - Exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process under examination. Make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments
- 3. Confidentiality** - Respect the value and ownership of information received. Do not disclose information without appropriate authority, except under legal or professional obligation to do so.
- 4. Competency** - Apply the knowledge, skills and experience required in the performance of internal auditing services and continually improve the proficiency, effectiveness and quality of *the* services provided.

## **Rules of Conduct**

### **1. Integrity**

Internal auditors:

- 1.1. Shall perform their work with honesty, diligence, and responsibility.
- 1.2. Shall observe the law and make disclosures expected by the law and the profession.
- 1.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.
- 1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

### **2. Objectivity**

Internal auditors:

- 2.1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.
- 2.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.
- 2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

### **3. Confidentiality**

Internal auditors:

- 3.1. Shall be prudent in the use and protection of information acquired in the course of their duties.
- 3.2. Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

### **4. Competency**

Internal auditors:

- 4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
- 4.2. Shall perform internal audit services in accordance with the *International Standards for the Professional Practice of Internal Auditing*.
- 4.3. Shall continually improve their proficiency and the effectiveness and quality of their services.

## **Standards of Conduct**

Internal Audit will adhere to the following standards of conduct:

- **Service.** Preserve a commitment to carry out all responsibilities with an attitude of service toward agency members while maintaining a sincere and dignified attitude.
- **Excellence.** Uphold a high standard of service and a commitment to quality in performing all projects and assignments.
- **Leadership.** Provide noteworthy examples which emphasize high ethical and moral standards.
- **Professionalism.** Conduct business in a manner that reflects favorably on the agency and the individual. Exercise skill, integrity, maturity and tact in all relations.



## **RESPONSIBILITY**

At minimum, Internal Audit is charged with the following responsibilities:

- Develop a flexible annual audit plan using an appropriate risk-based methodology, including any risks or control concerns identified by management, and submit that plan to the Agency's Chief of Staff for review and approval, as well as periodic updates.
- Implement the annual audit plan, as approved, including as appropriate any special tasks or projects requested by agency management and/or Chief of Staff.
- Coordinate and provide support and oversight of all external auditors and regulators. Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the university at a reasonable overall cost.
- Assist in the investigation of suspected irregularities or fraudulent activities impacting the agency and provide necessary reporting to the agency management and/or Chief of Staff.
- Provide reports to the Agency's Chief of Staff to communicate the final results of audits and reviews performed.
- Recommending improvement of management controls designed to safeguard resources and ensure compliance with government laws and regulations.
- Appraising the adequacy of the action taken by operating management to correct reported deficient conditions; accepting adequate corrective action; continuing reviews with appropriate management personnel on action considered inadequate until there has been a satisfactory resolution of the matter.
- Internal Audit has a professional responsibility to conduct reviews with an attitude of professional skepticism. Internal Audit recognizes that the application of internal auditing procedures may produce evidence indicating the possibility of errors, irregularities, or fraud. However, Internal Audit cannot be solely responsible for the detection and prevention of all errors, irregularities or fraud which may occur. This is a responsibility shared by all members of the agency management team.

Signature: \_\_\_\_\_ Date: \_\_\_\_\_  
Chief of Staff

Signature: \_\_\_\_\_ Date: \_\_\_\_\_  
State Treasurer



## **South Carolina Office of the State Treasurer**

### **Internal Audit Planning**

#### **III. Audit Planning**

Internal Audit is responsible for developing a risk based Audit Plan that includes areas subject to regulatory review, each fiscal year. The Audit Plan is a written document showing specific audits or projects to be performed by the Internal Audit Department. After review by the Agency Chief of Staff, the Audit Plan is presented to the State Treasurer for approval.

The development of the Audit Plan includes a review of the agency's risk assessment of the key processes. This is a process in which business process are identified and evaluated according to the goals of the agency, and goals of the individual area. An assessment of the level of risk is conducted in cooperation with each section and updated periodically. The assessment includes a broad range of risks and associated controls. In addition, Internal Audit is responsible to identify and evaluate exposures to business risk and the controls designed by management to reduce those risks. When doing so, the following factors are considered:

##### **(A) Ongoing Factors**

1. Financial value
2. Public image
3. Process liquidity
4. Asset liquidity
5. Budget deviations
6. Regulatory guidelines.

##### **(B) Environmental Risk factors**

1. Process stability
2. Recent audit history
3. Executive assessment
4. Political environment
5. Financial markets
6. Technology initiatives.

The majority of audits are planned. However, that does not preclude Internal Audit from conducting unplanned audits. Prior to any audit, Internal Audit will discuss the engagement with management. The discussion will include the scope, purpose and estimated timeframe of the audit. As unplanned projects are required, they are included in the overall plan for the year.

#### **IV. Audit Process**

##### **Overview and Conduct of the Audit Process**

Although every audit project is unique, the audit process is similar for most engagements and usually consists of nine stages. Through these stages Internal Audit will determine ways to minimize risks and increase efficiencies within the area. Client involvement is critical at each stage of the audit process.

An audit will result in a certain amount of time being diverted from area personnel's usual routine. One of the key objectives is to minimize this time and avoid disrupting on-going activities.

- **Plan**. The Internal Audit Department will develop an audit plan based on a review of all pertinent information. Sources may include, but are not limited to: a risk assessment, internal and external evaluations and management guidance. An engagement letter may be used for non-routine engagements (**Exhibit A**)
- **Notify**. The Internal Audit Department will schedule a meeting with the unit manager and the senior managers of the process to be audited. Identify the scope and objectives of the audit, how long it is expected to last and what the responsibilities for all parties are in the audit process. Any factors that may impact the audit should be raised at this time. Factors include vacations, fiscal year end reporting requirements, etc.
- **Test**. Testing will include interviews with the staff, review of procedures and manuals, assessing compliance with the agency policies and governmental laws and regulations in addition to assessing the adequacy of internal controls.
- **Communicate**. Keep the department that is undergoing the audit updated on the status of the audit on a regular basis, especially if there are any findings. There may be instances where the specific findings will be addressed immediately.
- **Draft**. The draft report will include the audit Scope and Objectives, Summary and Opinion, Findings and Audit Recommendations as necessary.
- **Management Response**. Management will receive the audit draft to confirm the facts and respond to the Audit Recommendations (when necessary). Their response should assign the responsibility and have a specific target date of completion for the corrective actions. The time window for the Management Response is normally 21 calendar days.
- **Review**. The final version of the Audit will be reviewed and determine if all issues were addressed and resolved by Internal Audit.
- **Distribute**. The report is then released to the audited department, the Deputy Director and the Chief of Staff.
- **Verify**. The Internal Audit Department will normally conduct a follow up on the Management Responses to the Audit Findings and Recommendations within a reasonable time frame. This subsequent review will be discussed with the involved management and the comments published. The comments may also be released to the Audit, Finance and Investment Committee as part of the agenda at the periodic meetings.

### **Risk Management**

Internal Auditors must be alert to significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified. The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.

Management is responsible for developing, operating and monitoring the system of internal control. To this end, management must have processes in place which ensure that controls are operating effectively. Such monitoring controls may include:

- A monthly checklist of key controls, signed by the staff responsible, as evidence that important checks have been carried out.
- Management approval of bank reconciliations to check for old, or unusual, items.



- Management review of edit reports to ensure computer processing controls are operating effectively.

The main tasks involved in an individual audit address both risks and management's monitoring of internal control. The individual risk based internal audit is very similar to a controls based audit in that it involves understanding the processes and controls involved and testing the controls to ensure they are operating properly. However, it is also very different from a controls-based audit in that it is driven by the risks identified by management.

Determining whether risk management processes are effective is a judgment, resulting from the internal auditor's assessment that:

- Organizational objectives support and align with the organization's mission
- Significant risks are identified and assessed
- Appropriate risk responses are selected that align risks with the organization's risk appetite; and
- Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, and management to carry out their responsibilities.

The internal audit activity may gather information to support their assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization's risk management processes and their effectiveness.

The audit work should be able to provide assurance that:

- Management has identified, assessed and responded to risks above the risk appetite.
- The responses, especially the system of internal controls treating the risks, are effective in reducing the inherent risks to below the risk appetite
- Where residual risks are above the risk appetite, action is being taken to reduce them to within the risk appetite or Management is informed that they will be tolerated
- Risk management processes are being monitored by management to ensure they continue to operate effectively.

For each of the risks covered, the audit should give reasonable assurance that:

- The risk is being managed to within the risk appetite of the agency or,
- Action has been agreed to bring the risk within the risk appetite or,
- The risk will have to be tolerated or,
- The risk is not being managed to within the risk appetite, and no suitable action is being taken.

The results of the audit are used to advise management on updating the risk inventory with the actual status of the residual risks.



## **V. Audit Procedures**

### **Evidential Matter**

Evidential matter obtained during the course of fieldwork provides the documented basis for the auditor's opinions, observations and recommendations as expressed in the auditor's opinions, observations and recommendations as noted in the audit report. The Internal Audit Department is obligated by professional standards to act objectively, exercise due professional care and collect sufficient and relevant information to provide a sound basis for audit observations and recommendations.

Auditors must obtain all evidence necessary for the effective completion of the audit. The decision on how much evidence is enough and what type to seek requires the exercise of the auditor's judgment based on experience, education and intuition. A thorough knowledge of the concepts underlying audit evidence will help the auditor to improve the audit quality and efficiency of the process.

Standards for the Professional Practice of Internal Auditing require that work papers possess certain attributes to provide a sound basis for audit observations and opinions and to be considered as evidential matter. These attributes are:

- Sufficient information is factual and adequate so that a prudent, informed person would reach the same conclusions as the auditor;
- Information is reliable and the best attainable through use of appropriate audit techniques;
- Relevant information supports audit findings and recommendations and is consistent with the audit objectives for the audit; and
- Useful information helps the organization meet its goals. It also provides a reference for the preparer when called upon to answer questions.

### **Types of evidence**

If the evidence supports the basic test of sufficiency, competence and relevance, it may be used to support the auditor's findings. The following outlines the different types of evidence obtained during the course of an audit:

- **Physical evidence.** Obtained through observation and inquiry;
- **Testimonial evidence.** Based on interviews and statements from involved persons;
- **Documentary evidence.** Consists of legislation, reports, minutes, memoranda, contracts, extracts from accounting records, formal charts and specifications of documentation flows, systems design, operational and organizational structure; and
- **Analytical evidence.** Secured by analysis of information collected by the auditor.

### **Documentation of Evidential Matter**

Standards for the Professional Practice of Internal Auditing require that audit work papers reflect the details of the evidence upon which the auditor has relied. The Internal Auditor must maintain adequate documentation of the audit, including the basis and extent of planning, the work performed and the results and findings of the audit. This will allow the work papers to serve both as tools to aid the auditor in performing their work and as written evidence of the work done to support the auditor's report. Information included in work papers should be sufficient and relevant to provide a sound basis for audit findings and recommendations.

In the process of collecting evidential matter, the auditor is required to perform audit testing to support all observations and opinions. During the performance of such testing, the auditor is not required to test the population in its entirety. Audit sampling may be employed. Audit sampling is performing an audit test on less than 100% of a population. In “sampling”, the auditor accepts the risk that some or all errors will not be found and the conclusions drawn (i.e. all transactions were proper and accurate) may be wrong. The type of sampling used and the number of items selected should be based on the auditors understanding of the relative risks and exposures of the areas audited.

### **Types of Samples**

- **Statistical or probability sampling.** Allows the auditor to stipulate, with a given level of confidence, the condition of a large population by reviewing only a percentage of the total items. Several sampling techniques are available to the auditor.
- **Attribute sampling.** Used when the auditor has identified the expected frequency or occurrence of an event.
- **Variable sampling.** Used when the auditor samples for values in a population which vary from item to item.
- **Judgment sampling.** Used when it is not essential to have a precise determination of the probable condition of the universe, or where it is not possible, practical or necessary to use statistical sampling.

### **Audit Findings**

Auditors should plan and perform procedures to develop the elements of an audit finding necessary to address the audit objectives. The elements of an audit finding include condition, criteria, cause, effect and recommendation.

- **Condition** (what wrong) is the situation that exists, which is determined and documented during the audit. It may be derived from any source of evidence.
- **Criteria** identify the required or desired state, or expectation with respect to the program or operation. Criteria provide the context for evaluating evidence. It is the benchmark against which performance is compared or evaluated.
- **Cause** identifies the reason for the factors responsible for the difference between the condition and criteria.
- **Effect** refers to the impact or potential impact of the difference between the condition and the criteria. It demonstrates the need for the recommended corrective actions.
- **Recommendation** refers to the corrective course of action to bring the condition in compliance with the criteria.

The identification of elements of a finding continues through all phases of the audit, with the ultimate goal of fully supported audit recommendations. Recommendations must be thoroughly developed and supported by sufficient, appropriate evidence in order to be included in the report. Once a finding is



identified, an audit inquiry form (**Exhibit B**) should be sent to the appropriate individuals in order to obtain a management response to the recommendation. Audit Inquiries are required to be approved by the Audit Manager prior to distribution to management for responses.

For some matters, early communication to those charged with governance or management may be important because of their relative significance and the urgency for corrective follow-up action. Further, when a control deficiency results in noncompliance with provisions of laws, regulations, contracts or grant agreements, or abuse, early communication is important to allow management to take prompt corrective action to prevent further noncompliance.

Prior to discussing any audit finding with the auditee, approval must be obtained from the Audit Manager. Agreement or disagreement with the facts of the finding and the recommendations should be noted. The expected implementation date should be stated when possible.

## **VI. Audit Reports**

### **Policy**

The internal auditor should communicate their audit results promptly, in an objective, clear, concise and constructive manner.

### **Description**

The internal audit report is the culmination of the auditor's research, analysis, and conclusion. It may be subject to review by parties internal or external to the agency, including external auditors, peer reviewers, oversight agencies, etc. The document itself informs the reader of the extent of the auditor's analysis, and the conclusions or results of that analysis. For many readers, this document will be the only point of contact made on the audit. Therefore, it is essential that the audit report sets the proper tone and the content is clear, concise and accurate.

### **Procedures**

1. All issues should be communicated to the Division Head through the use of audit inquiry (**Exhibit B**) prior to the issuance of the draft report. Once all steps of the audit program and the related analysis are completed, and the papers have been organized, the auditor should begin work on the audit draft report. Properly prepared audit recommendation completed throughout the course of the audit can be cut and paste, saving time in compiling the draft. Timely completion of the draft report is crucial and helps to ensure the information it contains is still pertinent to the audit client.
2. The auditor should prepare a draft report that includes the follow sections:

- **Introduction and Background**

Describe the type of engagement (regular scheduled, special request, etc.) and the authority of the audit (agenda, special request). Identify the program/function and processes being audited and provide any background information necessary to acquaint the reader. This can include nature and goals. Refer to prior audits, if applicable, and discuss status of prior recommendations that have not been implemented, if necessary.



- **Audit Objectives**

The audit objectives are stated in the report and are identical to those that appeared in the audit program. It is acceptable to reword them and reorder them as necessary; however, care should be taken to ensure the content is not changed. The objectives should always be clear and concise and should correspond to the Audit Conclusions.

- **Scope**

The scope should state the area/function reviewed, the type of review performed (i.e. operational, functional, financial), the risks being audited, the types of evidence used, and the primary objectives of the review. Also include any pertinent information the reader would need to know, such as data limitations, scope impairments or clarification of work performed. The objectives should be written as bullet-statements.

- **Methodology**

The methodology section should clearly explain the evidence gathering and analysis techniques used to accomplish the audit's objectives. For example, a description of audit procedures used and any sampling information would be included here.

- **Noteworthy Accomplishments**

This section will be used for the Auditor to recognize successes achieved by the audited entity. In order to present a less confrontational tone, and to maximize value of the audit, efforts should always be taken to recognize some level of success.

- **Observations and Recommendations**

This section should be used to document conditions which do not conform to the appropriate standards (e.g. ineffective controls and violations of law or policy). The auditor should also include recommendations that address the root cause.

- **Management's Action Plan**

All auditor recommendations will be followed by management's plan to address the condition. The action plan will be included verbatim.

- **Conclusion**

The auditor must conclude on the stated audit objectives in the order in which they appeared in the report. The auditor should conclude in the negative or affirmative on each objective. The conclusion should also be included in the Summary of Audit Results section of the Internal Auditor's Report cover page.

- **Acknowledgements**

This section is used to show appreciation for the efforts of management and staff in assisting the audit staff during the course of the audit engagement.

3. Along with the page number, the footer on each page of the draft report will contain the following statement:

*(Draft Document) Information in this report is confidential and proprietary.  
Use or disclosure of data is subject to the approval of the Internal Auditor and the General Counsel of SC  
Office of the State Treasurer*

4. Along with the page number, the footer on each page of the report will contain the following:

*South Carolina State Treasurer Office – Internal Audit  
Engagement No. X-XXXX-X  
[Report issued date] Page #*

5. The draft report should be cross-referenced to the workpapers and submitted, along with the workpapers, to the Audit Manager for review. The Audit Manager will review the report to ensure it is accurate and there is adequate documentation in the work papers to support the opportunities and recommendations of the report. The Audit Manager will also review the report for appearance, tone, grammar and other standard reporting requirements.
6. The auditor should also prepare a distribution list at this time. The distribution list should include the area management, person(s) that the area reports to directly. The Audit Manager should review the list and make any additions or deletion as necessary. This list will be used to prepare the cover letters discussed below.
7. The Audit Manager will return the draft and discuss any changes with the auditor in a timely manner (typically within one week). Once the necessary changes are made, the auditor will resubmit the draft for review. Once the Senior Auditor has completed this second review, and sees no further changes necessary, the draft is ready for distribution.
8. The auditor should prepare a cover memo for the area's Deputy State Treasurer (**Exhibit C**) with acknowledgements for the area's Deputy State Treasurer to sign. These acknowledgements provide documentation that they reviewed the draft prior to the distribution of the final report (**Exhibit D**). A cover memo will also be issued to audited area management, requesting any changes to responses in the report, and stating a due date for the responses and a due date for the client to request an exit conference (**Exhibit E**). This cover memo will also indicate that if no response is received, the final report will be developed without a Management Response detailed in the Draft Report.
9. Once the responses to the draft report are received, (via email) they should be provided to the Audit Manager. The Audit Manager will review and forward back to the auditor. Both should review the responses to ensure appropriateness to the recommendations. If there appears to be a misunderstanding by the client on the content of the report, or the recommendation, the auditor should contact the client (preferably in writing) and try to properly communicate the intent of the report/recommendation. If necessary, the auditor should ask for a new response.
10. The auditor should follow up with any areas which responses have not been received by the due date stated in the draft. This follow up should be done in writing, via email. Non-response should be reported to senior management for further resolution.
11. The responses should be incorporated into the final report, placed just below the corresponding recommendation. If this final report includes recommendations to multiple areas, the auditor should specify the area from which the response was received. It may be necessary to include an "Auditor's Comment" following the response if the auditor feels that further clarification is necessary. The Auditor should not, however, use the Auditor's Comment as a forum to rebut any response.



12. An executive summary should be prepared and addressed to the agency's Chief of Staff.
13. Both the Final Report and the Executive Summary should be submitted to the Audit Manager for review/approval. If no changes are needed, the Audit Manager will review both documents and sign them.
14. Follow-up reviews will be scheduled by the Audit Manager during the annual audit plan preparation process. The Audit Manager will develop the most effective method to perform follow-up reviews.

## **VII. External Auditors**

### **Policy**

Internal Audit should coordinate activities with external auditors, consultants, and providers of assurance services (collectively referred to as "externals" for the remainder of this policy) so as to ensure proper coverage, limit duplication of efforts, and achieve fee containment.

### **Procedures**

The Audit Manager shall be in charge of the overall coordination and scheduling of internal and external audit efforts. The Audit Manager will determine the level of direct and indirect assistance required and available. Once the level of assistance to be provided is determined, the Audit Manager will designate an auditor to assist with the coordination. The auditor's duties when assisting with the coordination effort will include, as necessary:

- Making arrangements for the date, time, place and list of attendees for an entrance conference, and communicating this information to all who may need to know.
- Making the necessary arrangements for adequate working space for the externals.
- Any requests for information or documentation should be communicated to management in writing. A file should be maintained of all information requested, the date requested, and the date submitted to the externals. Any original documents to be returned to management should be closely monitored by the auditor.
- When pre-audit information is requested by externals prior to their visit on-site, the auditor should, whenever possible, make and retain a copy of all documents and materials before they are provided (i.e. emailed).
- At the entrance conference, the auditor should:
  - ✓ Perform introductions between externals and the other management representatives in attendance.
  - ✓ Distribute a sign-in sheet, to include name, department, and extension.
  - ✓ Inform externals and others in attendance where the workspace for the externals is located.
  - ✓ Discuss, or invite externals to discuss, the reason for the audit, the objectives and scope of the audit, the timeframe covered by the audit, and the expected duration of the audit.
- The auditor may be asked to perform portions of the externals' audit programs. If so, the auditor should complete the assignment with the same level of objectivity as they would on all assignments, and will still report to the Audit Manager during this period. The Audit Manager will discuss with the auditor, the guidelines of the assignment, including the level of assistance that the auditor is expected to provide. The auditor should ensure that the work they perform throughout the assignment falls within those guidelines for audit assistance. The auditor should confer with the Audit Manager when a question about acceptability arises.

- At the conclusion of the review, the auditor should ensure that supplies and original documents are returned to the proper department/location.

## **VIII. Follow-up Reviews**

### **Performance Standard 2500 – Monitoring Progress**

Standards for the Professional Practice of Internal Auditing require the chief audit executive (Audit Manager) to establish and maintain a system to monitor the disposition of results communicated to management. Implementation Standard 2500.A1 requires a follow-up process to monitor and ensure that management actions have been effectively implemented or management has accepted the risk of not taking action

### **Performance Standard 2600 – Management’s Acceptance of Risk**

When the chief audit executive (Audit Manager) believes that senior management has accepted a level of residual risk that is unacceptable to the organization, the chief audit executive (Audit Manager) should discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive and senior management should report the matter to the State Treasurer for further resolution.

### **Internal Audit’s Procedures**

To comply with the aforementioned Standards of Professional Practice, Internal Audit will use the following procedures for follow-up reviews:

#### **A. Scheduling Follow-up Activities**

The Audit Manager is responsible for scheduling follow-up activities as part of the annual audit plan and the current audit schedule. The budget hours allocated to follow-up will be estimated and included in the audit planning process.

#### **B. Definition and Objective of Follow-up Review**

Follow-up is defined as a process by which Internal Audit determine the adequacy, effectiveness and timeliness of actions taken by management on reported findings. Internal Audit will determine if corrective action taken is achieving the desired results, or that management has assumed the risk of not taking corrective action on reported findings.

#### **C. Planning and Scheduling a Follow-up Review**

The following steps should be taken in planning and scheduling a follow-up review:

1. The “Status of Audit Recommendations” spreadsheet from the original audit should be used as the basis for planning the follow-up review. The auditor should note the recommendations and corresponding management responses from the original audit.
2. A follow-up review engagement letter (**Exhibit F**) should be sent to management, to (a) explain the objective of the review, (b) schedule a time for follow-up fieldwork, as applicable and (c) request a report, or appropriate document outlining the current status of the actions agreed upon in response to the original audit report recommendations (along with supporting documentation). It is advisable to correspond with the auditee/management by phone prior to sending the letter



3. Follow-up reviews will not include an opening and closing conference, and the scope should be limited to the findings included in the original audit report and any non-reportable conditions resulting from the original audit.

#### **D. Management Responsibility**

Management is responsible for deciding the appropriate action to be taken in response to reported audit findings. Management has an ethical responsibility to address the recommendations agreed upon in the management response section of the original audit report. Internal Audit is responsible for assessing management action for timely resolution of the issues reported.

#### **E. Management's Acceptance of Risk**

Management may decide to assume the risk of not correcting the reported condition because of cost, or some other factors. The follow-up report or memo will reflect management's decision. See Performance Standard 2600 above for additional guidelines.

#### **F. Factors that should be considered**

Factors which should be considered in determining appropriate follow-up include, but may not be limited to:

1. The significance and overall impact of the reported condition.
2. The degree of effort and resources needed to correct the reported condition.
3. The risk that may occur should the corrective action fail.
4. The complexity of the corrective action and the time needed for implementation.

#### **G. The Extent of Follow-up Testing**

The scope of the follow-up review should be based on the nature of the audit issues, the complexity of the corrective action and the level of confidence needed to verify management's commitment to implementing corrective action. Unless extenuating circumstances are present, the review should be limited to evaluation of the specific actions taken on the audit recommendations reported in the initial report. The following provides general guidelines for the scope of follow-up activity:

##### **1. Informal Follow-up Review**

This is the most basic form of follow-up and may be satisfied by examining the status report, reviewing auditee/management's procedures, or with an informal telephone conversation or memo correspondence. This type of follow-up is usually applicable to the less critical conditions.

##### **2. Limited Follow-up Review**

Limited follow-up typically involves more interaction with the auditee. This may involve actually verifying procedures or transactions, and in most cases is not accomplished merely through memos or telephone conversations with management.

##### **3. Detailed Follow-up Review**

Detailed follow-up is usually more time-consuming and can include substantial involvement with the auditee. Verifying procedures and audit trails, as well as substantiating balances, records, etc. are examples. More critical audit conditions may require detailed follow-up.

#### **H. Follow-up Report**

A formal follow-up report or memorandum will be issued in draft form and distributed to the original audit report recipients, as applicable. The status of corrective action or management's waiver of resolution (and the corresponding acceptance of risk) will be included in the report. Once the draft report, or memorandum is issued, procedures outlined for issuing audit reports should be followed.

#### **I. Non-reportable Matters (Observations)**

During the follow-up, the auditor will also perform procedures to determine if any non-reportable items that existed during the original audit have been satisfactorily resolved. If these matters have not been resolved, a reportable condition may be included in the follow-up audit report.

#### **J. Conditions Still Exist**

If the conditions still exist as a result of the follow-up review, the Audit Manager will elevate the concerns to Chief of Staff, as applicable. See Performance Standard 2600 above for additional guidelines.



South Carolina Office of the State Treasurer  
Internal Audit Department



MEMORANDUM

Date: January 29, 2016

To: Division Head

From: Allen R. Townsend, Financial Audit Manager

Subject: [Audit title], Audit No. [Audit #]

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In accordance with our fiscal year 20XX Audit Plan, we will conduct an audit of the [process] in the [function/activity area]. We anticipate beginning fieldwork on [date]. The objective of our audit is to provide assurance that controls are effective to ensure that risks relative to the process described above are managed to within an acceptable level. Our audit will be planned and performed using proficiency and due professional care in order to obtain sufficient, appropriate evidence to provide a reasonable basis for our observations and conclusions based on our objective. [Auditor's name] of our staff will conduct the audit and I will supervise the engagement. We will contact you in order to arrange an entrance conference to discuss the various aspects of our audit. Further we will be providing a questionnaire that will help us to more effectively plan the engagement. Please complete the questionnaire and return to [name of auditor via email] by [date]. Should you have any questions, or concerns, regarding this engagement, please feel free to contact me at 803-734.2635. We look forward to working with you and your staff.

South Carolina Office of the State Treasurer  
Internal Audit Department



Audit Inquiry

To:	Audit Area:
From:	Subject:
Date:	Please Respond By:



South Carolina Office of the State Treasurer  
Internal Audit Department



MEMORANDUM

Date: January 29, 2016

To: Deputy Director

From: Allen R. Townsend, Financial Audit Manager

Subject: Audit of Selected Area/Division

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Attached is a draft of the report we plan to issue based on our recent audit of the Audit of Selected Area/Division. Please return the attached statement acknowledging receipt and review of the report.

Your review and acknowledgement, in a timely manner, will be greatly appreciated.

South Carolina Office of the State Treasurer  
Internal Audit Department



I acknowledge I have received and reviewed the Draft Report of the Audit of Selected  
Area/Division issued on January 29, 2016.

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Date

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Deputy Director's Name & Title



South Carolina Office of the State Treasurer  
Internal Audit Department



MEMORANDUM

Date: January 29, 2016

To: Section/Division Managers

From: Allen R. Townsend, Financial Audit Manager

Subject: Audit of Selected Area/Division

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Attached is a Draft Audit Report of the report we plan to issue based on our recent audit of the Audit of Selected Area/Division. The attached Draft Audit Report is being issued to provide you the opportunity to suggest any changes prior to issuance of the final report.

We would like to schedule an Exit Conference at your earliest convenience, but prior to February 19, 2016, to discuss the contents of the attached report, as our intentions are to distribute the final report on February 22, 2016. However, if you feel an exit conference is not necessary, please provide a written response declining the Exit Conference by February 19, 2016. Your response should take the form of specific action to be taken with respect to each issue and recommendation. If a response is not received, the final report will be issued with the management responses detailed in the draft report.

A copy of the draft report is being forwarded to the applicable Deputy Director requesting acknowledgement and review of the report.

## South Carolina Office of the State Treasurer Internal Audit Department



### MEMORANDUM

Date: January 29, 2016  
To: Section/Division Managers  
From: Allen R. Townsend, Financial Audit Manager  
Subject: Follow-up Review, Audit of Selected Area/Division

In compliance with Internal Auditing standards which requires the monitoring of audit recommendations communicated to management, a follow-up review of the Audit of Selected Area/Division conducted in 2015, has been scheduled.

The objective in a follow-up review is to ensure that corrective actions of the audit recommendations have been effectively implemented by management, or that management has accepted the risk of not taking action. Based on the audit issues and the complexity of the corrective action, the scope of this follow-up review will be limited, and only involve evaluation of the specific actions taken on the audit recommendations reported in the initial report.

During the follow-up review, we may also perform procedures to determine if any non-reportable matters that existed during the original audit have been satisfactorily resolved. If these issues have not been resolved, a reportable comment may be included in the follow-up report.

An Auditor from our office will contact you by February 15, 2016 to make arrangements for providing documents and any other information to begin our follow-up review.

Our goal is to conduct an effective and efficient follow-up review, and to add value to your operations. To that end, we would like to thank you in advance for your assistance and cooperation. Should you have any questions, or concerns, please do not hesitate to call me at 803-734-2634.



## **Bibliography**

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- Government Finance Officers Association – GFOA Best Practice: Establishing an Internal Audit Function, Approved by the GFOA's Executive Board, February 2006. [www.gfoa.org](http://www.gfoa.org)
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- Internal Auditor Policy & Procedures Manual – SC State University, Office of Internal Audit, Updated January 2011
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